Harsher Offshore Voluntary Disclosure Penalties Announced for Willful Non-Reporting Taxpayers

Client Advisories

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The IRS has announced additional guidance with respect to certain taxpayers who held or are holding accounts at foreign financial institutions that have been publicly identified as being under IRS or U.S. Justice Department investigation. The failure of such account holders to comply with reporting requirements prior to July 1, 2014, is considered by the IRS to be willful in nature. Such taxpayers who now come forward under the Offshore Voluntary Disclosure Program (OVDP) will face a penalty of 50% of the highest value of their offshore accounts over the previous eight years. The prior 27.5% penalty will continue to apply for non-reporting taxpayers whose accounts or advisors were not publicly identified as subject to U.S. governmental action prior to applying for the OVDP.

HOLDERS OF ACCOUNTS IN FINANCIAL INSTITUTIONS UNDER INVESTIGATION

Since 2008, the IRS has vigorously confronted foreign financial institutions that were assisting U.S. taxpayers to avoid the reporting of taxable income. The IRS and the U.S. Justice Department initiated investigations and issued summonses against many foreign financial institutions, many of which resulted in settlement agreements and some in criminal judgments. According to the question and answer format of the Offshore Voluntary Disclosure Program:

“Beginning on August 4, 2014, any taxpayer who has an undisclosed foreign financial account will be subject to a 50-percent miscellaneous offshore penalty if, at the time of submitting the preclearance letter to IRS Criminal Investigation: an event has already occurred that constitutes a public disclosure that either (a) the foreign financial institution where the account is held, or another facilitator who assisted in establishing or maintaining the taxpayer’s offshore arrangement, is or has been under investigation by the IRS or the Department of Justice in connection with accounts that are beneficially owned by a U.S. person; (b) the foreign financial institution or other facilitator is cooperating with the IRS or the Department of Justice in connection with accounts that are beneficially owned by a U.S. person or (c) the foreign financial institution or other facilitator has been identified

in a court-approved issuance of a summons seeking information about U.S. taxpayers who may hold financial accounts (a "John Doe summons") at the foreign financial institution or have accounts established or maintained by the facilitator. Examples of a public disclosure include, without limitation: a public filing in a judicial proceeding by any party or judicial officer; or public disclosure by the Department of Justice regarding a Deferred Prosecution Agreement or Non-Prosecution Agreement with a financial institution or other facilitator. A list of foreign financial institutions or facilitators meeting this criteria is available."

This guidance suggests that it is not the individual taxpayer's knowledge of an action against a financial institution that controls the penalty amount, but rather whether a public disclosure of the action has been made. It is not altogether clear whether a customer of a bank or facilitator not on the list as identified by the IRS can still qualify for the 27.5% penalty if notified by the bank of the IRS reporting requirements. Many banks have sent letters to depositors and former depositors that states that their names may be disclosed to the IRS. Whether this disclosure, without public dissemination, is enough to enable a person to claim a 27.5% penalty is an issue that will await further case law or IRS guidance.

Should you have any questions about foreign income issues or other tax matters, please contact any member of Archer's Tax Law Practice Group in Haddonfield, N.J., at (856) 795-2121, or in Wilmington, Del., at (302) 777-4350. For more information on the new streamlined procedures to the offshore voluntary disclosure program, click HERE.

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